

*The Management's Discussion and Analysis provides a narrative overview and analysis of the financial activities of the State.*

# Management's Discussion and Analysis

The following is a discussion and analysis of the State of Missouri's (the State's) financial activities for the fiscal year ended June 30, 2004. Readers are encouraged to consider the information presented here in conjunction with additional information that is furnished in the letter of transmittal.

## HIGHLIGHTS

### Government-wide:

- Assets of the State's governmental activities exceeded liabilities by \$27.3 billion, a decrease in net assets of \$396.3 million or 1.4% from the prior year. Of this amount, \$767.6 million was reported as "unrestricted net assets" which represents the amount available to fund priority programs. The decrease in net assets was primarily caused by increased long-term liabilities for claims and bonds payable.
- Liabilities of the State's business activities exceeded assets by \$78.1 million, a decrease in net assets of \$174 million or 181.3% from the prior year. This decrease was primarily related to the Unemployment Compensation Fund which was forced to borrow federal money when expenses exceeded revenue and transfers by \$180.1 million.

### Fund-level:

- Governmental fund assets exceeded liabilities by \$3.4 billion, an increase of \$243.4 million or 7.8% from the prior year. Fund net assets were improved because revenue growth was approximately 3.6% during fiscal year 2004. Further, cost saving measures including reducing agency budgets, state employee layoffs, and the consolidation of buying power were utilized.

### Debt Issued and Outstanding:

- The primary government's total long-term obligations related to bonds payable increased \$172 million or 7.4% over the prior year. The outstanding bonds payable represents 44.1% of financial assets (cash, receivables, and investments) and 7.5% of total assets. The net increase in bonds payable resulted from decreases of \$76,475,000 due to bond payments and \$271,935,000 due to bond refundings and increases of \$520,335,000 due to issuances of General Obligation, State Road and Other Bonds. Additional detail is available in *Note 12*.

### Revenue Limit:

- The State Constitution limits the State's ability to retain revenue collected over an amount set by a constitutional amendment known as Article X or the Hancock Amendment. Excess revenue must be refunded to the taxpayers each year. During fiscal year 2004, the State did not exceed the revenue limit.

## OVERVIEW OF THE FINANCIAL STATEMENTS

The State's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

### Government-wide financial statements:

The government-wide financial statements are designed to provide readers with a broad overview of the State's finances, in a manner similar to a private-sector business.

The *Statement of Net Assets* presents information on all of the State's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of the State's financial position.

The *Statement of Activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of when the cash is received. Thus, revenues and expenses are reported in the statement for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements report three activities:

*Governmental Activities* are primarily supported by taxes and intergovernmental revenues. They include general government, education, natural and economic resources, transportation and law enforcement, and human services.

*Business-Type Activities* are intended to recover all or a significant portion of their costs through user fees and charges. They include constructing and operating state park facilities, fairgrounds, historical properties and office buildings, hospital services, warehousing, merchandising, publishing maps and documents, insurance coverage, and the operation of the State Lottery, Unemployment Compensation, and the Petroleum Storage Tank Insurance funds.

*Discretely Presented Component Units* are operations for which the State has financial accountability, but are legally separate. They include colleges and universities, the Development Finance Board, Agricultural and Small Business Development Authority, and various highway transportation corporations.

#### **Fund financial statements:**

The fund financial statements present more detail about the government's operations than the government-wide statements. The State uses fund accounting to ensure and demonstrate compliance with statutory requirements. All of the funds of the State can be divided into three categories: governmental, proprietary, and fiduciary funds.

*Governmental funds* are used to account for most of the basic services provided by the State. Unlike the government-wide financial statements, governmental fund financial statements focus on short-term inflows and outflows of current financial resources and utilize the modified accrual basis of accounting. This presentation focuses on when cash will be received and disbursed making the statements useful in evaluating a government's financing requirements in the near future.

Governmental funds include the general, special revenue, capital projects, debt service, and permanent funds. Major Funds include general, public education, conservation and environmental protection, transportation and law enforcement, and the State Road Fund which are presented in separate columns. Data from other governmental funds are combined into a single column for aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the form of combining statements.

In order for the user to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements, a reconciliation to facilitate this comparison is provided on the page immediately following each governmental fund financial statement.

*Proprietary funds.* Proprietary funds are used to account for activities similar to private businesses in which goods and services are sold for specified fees. Generally, the State uses enterprise funds to account for activities that provide goods and services to the general public. These include constructing and operating state park facilities, fairgrounds, historical properties and office buildings, hospital services, warehousing, merchandising, publishing maps and documents, and the operation of the State Lottery, Unemployment Compensation, and the Petroleum Storage Tank Insurance funds. Internal service funds report activities that provide supplies and services for the State's other programs and activities. The State uses internal service funds to account for insurance and health-care plans, as well as administrative services for other state agencies, such as fleet management, data processing, and telecommunication services. Because these services predominately benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements.

Proprietary funds focus on economic resources and utilize the full accrual basis of accounting. The proprietary fund financial statements provide separate information for the State Lottery, Unemployment Compensation, and Petroleum Storage Tank Insurance, which are considered major enterprise funds. All internal service funds are combined into a single column in the proprietary fund financial statements. Non-major enterprise funds are combined into a single column for aggregated presentation. Individual fund data for the non-major enterprise and internal service funds is provided in the form of combining statements in supplementary information.

*Fiduciary funds.* Fiduciary funds are used to account for resources held for the benefit of parties outside the state government. Fiduciary funds are *not* reflected in the government-wide financial statement because the resources of those funds are not available to support the State's own programs. The accounting used for fiduciary funds is similar to that used for proprietary funds.

**Notes to the financial statements.** The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

**Other information.** In addition to the basic financial statements and accompanying notes, this report also presents required supplementary information (RSI) including a budgetary comparison schedule for the general fund and major special revenue funds. Other supplementary information includes the combining statements for the general, non-major governmental, non-major enterprise, internal service, fiduciary, and non-major component unit funds. It also includes the statistical section as well as budgetary comparison schedules for the State Road, non-major special revenue, debt service, and permanent funds.

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

### Net Assets:

The following table displays the current and prior year government-wide condensed Statement of Net Assets.

STATEMENT OF NET ASSETS						
(In Thousands of Dollars)						
	Governmental Activities		Business-Type Activities		Total	
	2004	2003*	2004	2003*	2004	2003*
<b>ASSETS:</b>						
Current and Other Assets	\$ 5,348,843	\$ 5,241,571	\$ 398,023	\$ 286,828	\$ 5,746,866	\$ 5,528,399
Capital Assets, Net	27,315,652	27,061,983	53,626	53,186	27,369,278	27,115,169
<i>Total Assets</i>	<u>32,664,495</u>	<u>32,303,554</u>	<u>451,649</u>	<u>340,014</u>	<u>33,116,144</u>	<u>32,643,568</u>
<b>LIABILITIES:</b>						
Other Liabilities	1,317,180	1,386,293	305,128	15,741	1,622,308	1,402,034
Long-Term Liabilities						
Outstanding	4,029,075	3,202,706	224,574	228,298	4,253,649	3,431,004
<i>Total Liabilities</i>	<u>5,346,255</u>	<u>4,588,999</u>	<u>529,702</u>	<u>244,039</u>	<u>5,875,957</u>	<u>4,833,038</u>
<b>NET ASSETS:</b>						
Invested in Capital Assets,						
Net of Related Debt	25,360,979	25,286,468	52,291	51,803	25,413,270	25,338,271
Restricted	1,189,656	1,049,073	(73,743)	113,109	1,115,913	1,162,182
Unrestricted	767,605	1,379,014	(56,601)	(68,937)	711,004	1,310,077
<i>Total Net Assets</i>	<u>\$ 27,318,240</u>	<u>\$ 27,714,555</u>	<u>\$ (78,053)</u>	<u>\$ 95,975</u>	<u>\$ 27,240,187</u>	<u>\$ 27,810,530</u>
*Fiscal year 2003 amounts have been restated.						

The State's total net assets decreased \$570.3 million dollars or 2.1% during fiscal year 2004. This decrease resulted from increases in bonds and claims payable. Capital assets net of related debt and restricted assets, which do not represent resources available to pay day-to-day operating expenses, increased by \$28.7 million or 0.1%.

The largest component of the State's net assets at \$25.4 billion or 93.3% is invested in capital assets net of related debt, such as bonds payable or capital lease obligations. These assets include land, infrastructure, buildings, and equipment which are not easily converted to cash nor readily available to pay state debts as they come due.

Restricted net assets of the primary government totaled \$1.1 billion or 4.1% of total net assets, a decrease of 4.0% from the prior year. Net assets are restricted for several reasons including constitutional, legal, or external requirements. Examples of restricted net assets include lottery proceeds restricted for public education, funds restricted for debt service, and certain sales taxes restricted for the maintenance of highways or state parks and conservation areas. Also, many federal funds are restricted to funding certain programs.

## Changes in Net Assets:

The following table displays the current and prior year government-wide condensed Statement of Activities.

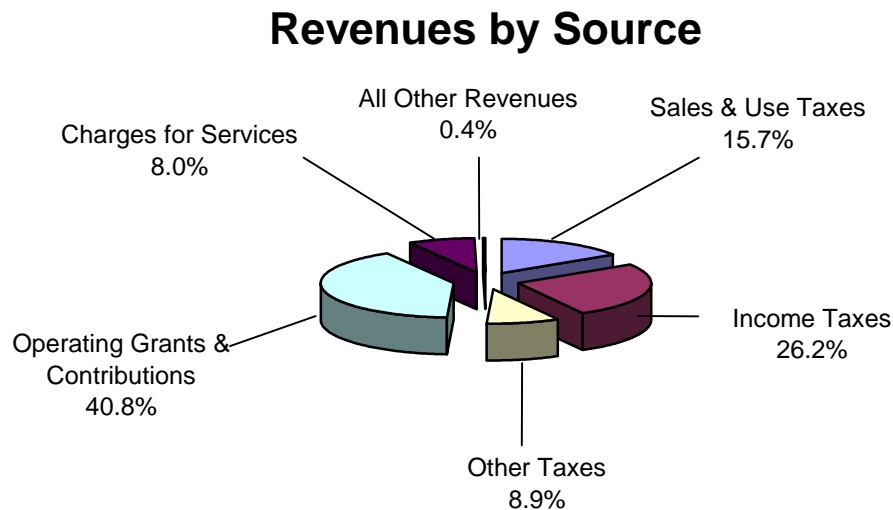
<b>STATEMENT OF ACTIVITIES</b>						
(In Thousands of Dollars)						
	Governmental Activities		Business-Type Activities		Total	
	2004	2003*	2004	2003*	2004	2003*
<b>REVENUES:</b>						
Program Revenues:						
Charges for Services	\$ 1,446,914	\$ 1,518,752	\$ 861,705	\$ 784,122	\$ 2,308,619	\$ 2,302,874
Operating Grants and Contributions	7,328,163	7,205,677	538,948	508,285	7,867,111	7,713,962
General Revenues:						
Sales and Use Taxes	2,827,294	2,668,522	---	---	2,827,294	2,668,522
Income Taxes	4,713,163	4,733,323	---	---	4,713,163	4,733,323
Unemployment and Other Taxes	1,598,490	1,528,952	---	---	1,598,490	1,528,952
Other Revenues	64,736	79,428	(5,722)	16,380	59,014	95,808
<i>Total Revenues</i>	<u>17,978,760</u>	<u>17,734,654</u>	<u>1,394,931</u>	<u>1,308,787</u>	<u>19,373,691</u>	<u>19,043,441</u>
<b>EXPENSES:</b>						
General Government	753,849	574,419	---	---	753,849	574,419
Education	5,377,291	5,303,365	---	---	5,377,291	5,303,365
Natural and Economic	1,030,612	485,384	---	---	1,030,612	485,384
Transportation and Law Enforcement	1,763,705	1,855,132	---	---	1,763,705	1,855,132
Human Services	8,830,049	8,492,667	---	---	8,830,049	8,492,667
State Lottery	---	---	575,067	522,176	575,067	522,176
Unemployment Compensation	---	---	695,647	747,531	695,647	747,531
Petroleum Storage Tank	---	---	12,281	48,818	12,281	48,818
All Other Expenses	838,572	725,537	66,961	57,292	905,533	782,829
<i>Total Expenses</i>	<u>18,594,078</u>	<u>17,436,504</u>	<u>1,349,956</u>	<u>1,375,817</u>	<u>19,944,034</u>	<u>18,812,321</u>
Increase (Decrease) in Net Assets before Transfers	(615,318)	298,150	44,975	(67,030)	(570,343)	231,120
<i>Transfers</i>	<u>219,003</u>	<u>200,664</u>	<u>(219,003)</u>	<u>(200,664)</u>	<u>---</u>	<u>---</u>
Change in Net Assets	(396,315)	498,814	(174,028)	(267,694)	(570,343)	231,120
<i>Net Assets—July 1</i>	<u>27,714,555</u>	<u>27,215,741</u>	<u>95,975</u>	<u>363,669</u>	<u>27,810,530</u>	<u>27,579,410</u>
<i>Net Assets—June 30</i>	<u>\$ 27,318,240</u>	<u>\$ 27,714,555</u>	<u>\$ (78,053)</u>	<u>\$ 95,975</u>	<u>\$ 27,240,187</u>	<u>\$ 27,810,530</u>
*Fiscal year 2003 amounts have been restated.						

As shown on the above schedule, net revenue collections increased by 1.7% over fiscal year 2003. Expenses increased by 6.0% over fiscal year 2003. Those functions with the largest percentage increase include Natural and Economic with 5.2% of total expenses in 2004 vs. 2.6% of total expenses in 2003 and General Government with 3.8% of total expenses in 2004 vs. 3.1% of total expenses in fiscal year 2003.

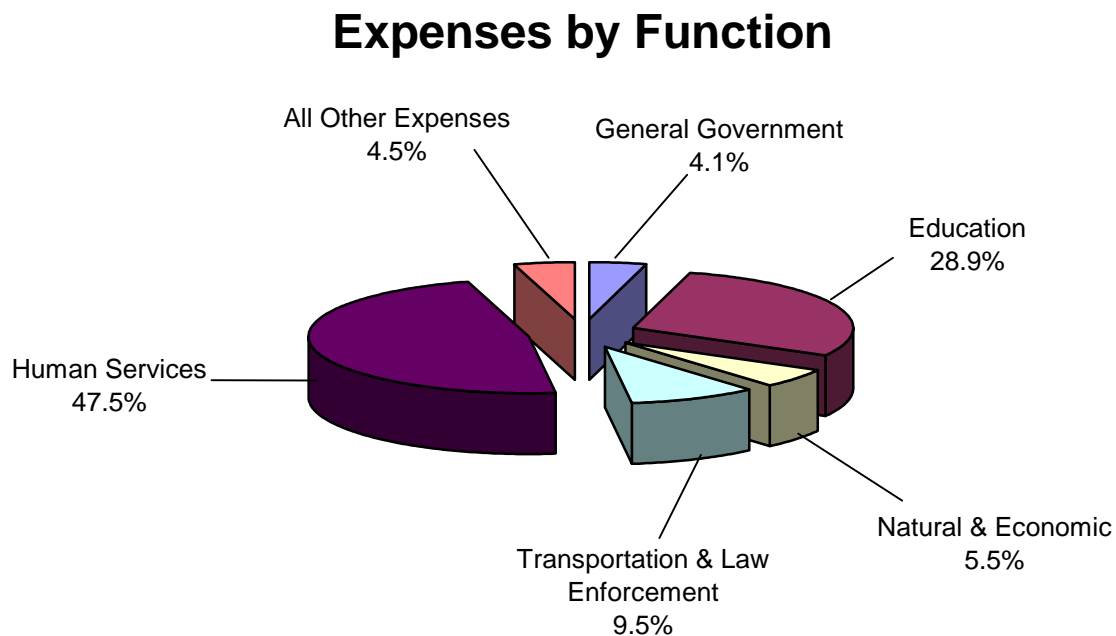
### Governmental Activities:

Governmental activities decreased the State's net assets by \$396.3 million due to expense growth in natural and economic and human services. Due to limited growth in tax collections, revenue growth was outpaced by expense growth.

The following chart depicts revenues of the governmental activities for the fiscal year:



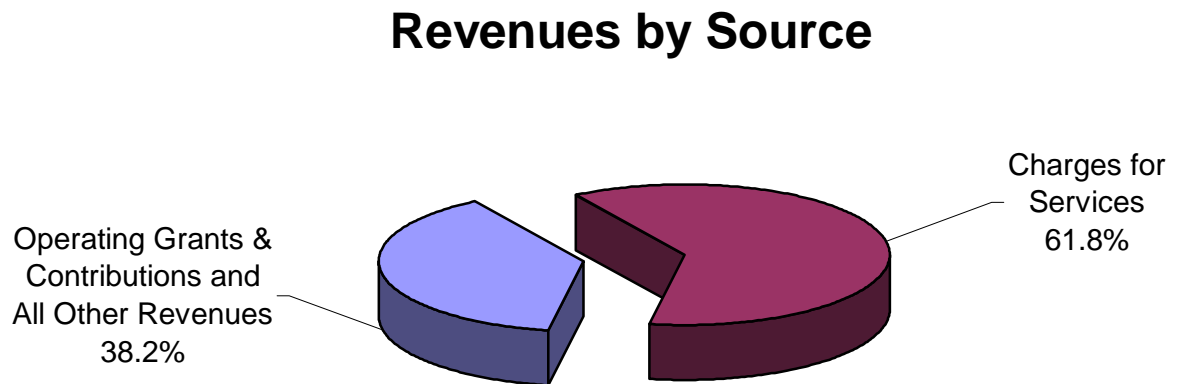
The following chart depicts expenses of the governmental activities for the fiscal year:



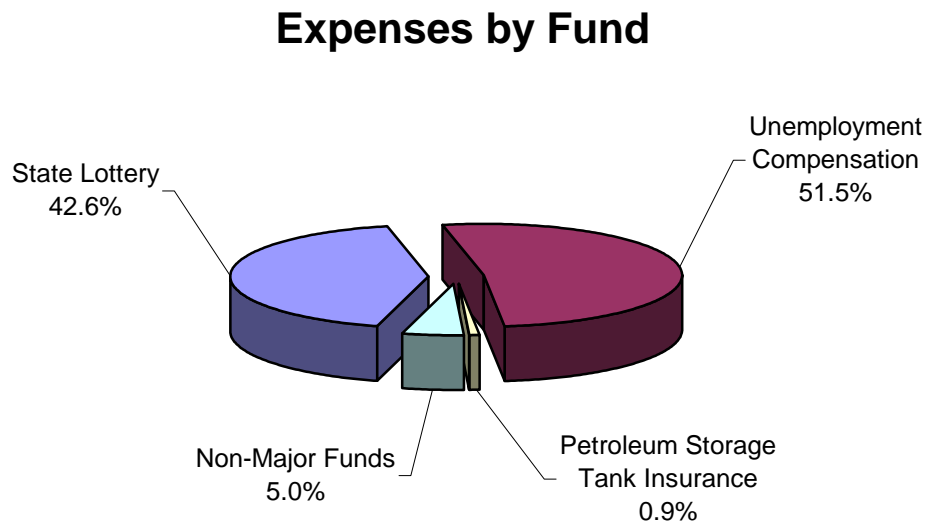
### Business-Type Activities:

Net assets of the business-type activities decreased by \$174 million during the fiscal year. The primary reason net assets declined relates to the Unemployment Compensation Fund where benefit payments far outpaced employer contributions and Federal loans were obtained for the difference. Lottery also had a significant decline in net assets because of increased transfers to education, however, the decline was offset across all business activities because of gains in the Petroleum Storage Tank Insurance Fund.

The following chart depicts revenues of the business-type activities for the fiscal year:



The following chart depicts expenses of the business-type activities for the fiscal year:



## FINANCIAL ANALYSIS OF THE STATE'S FUNDS

### Governmental Funds:

As of the end of fiscal year 2004, the State's governmental funds reported combined ending fund balances of \$3.4 billion, an increase of \$243.4 million or 7.8% over fiscal year 2003. Approximately 60.4% of this amount constitutes unreserved fund balance, which is available for spending at the government's discretion. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed: 1) for budget reserve, 2) to pay debt service, 3) for loans receivable, and 4) for a variety of other restricted purposes (see *Note 1*).

Fund balances (in thousands) for governmental funds are as follows:

	General Fund	Public Education	Conservation and Environmental Protection	Transportation and Law Enforcement	State Road	Non- Major	Total
Unreserved	\$ 626,884	\$ 197,632	\$ 415,604	\$ 123,297	\$ 223,136	\$ 441,467	\$ 2,028,020
Reserved	548,469	49	523,599	9,085	106,739	143,725	1,331,666
<b>Total</b>	<b>\$ 1,175,353</b>	<b>\$ 197,681</b>	<b>\$ 939,203</b>	<b>\$ 132,382</b>	<b>\$ 329,875</b>	<b>\$ 585,192</b>	<b>\$ 3,359,686</b>

The General Fund is the chief operating fund of the State. At the end of fiscal year 2004, the State's General Fund reported a total fund balance of \$1.2 billion. The net increase in fund balance during fiscal year 2004 was \$193.6 million. Revenues of the general fund totaled \$13.9 billion in fiscal year 2004, an increase of \$646.5 million from fiscal year 2003. Factors contributing to this increase included the following:

- Revenue from taxes increased \$417 million from fiscal year 2003 to fiscal year 2004. The most significant increase was Individual Income Tax, which increased \$202 million or 4.6%. This increase was due to continued economic growth.
- Contributions and intergovernmental revenues increased by \$371.6 million during fiscal year 2004 due primarily to an increase of \$125 million in federal receipts for grants or programs financed by the U.S. Department of Health and Human Services and an increase of \$99.5 million from federal receipts for grants or programs financed by miscellaneous federal sources.
- Cost reimbursement/miscellaneous revenues decreased \$93.5 million in fiscal year 2004. This was primarily due to a decrease within recovery costs of \$114.1 million because of a reduction in money recovered from outside parties.

Expenditures of the General Fund totaled \$11.5 billion in fiscal year 2004, an increase of \$110.1 million from fiscal year 2003. The factors contributing to the increase included the following:

- An increase to human services expenditures of \$306.8 million due primarily to a \$218.1 million increase in payments for mental health services provided. There was also an increase of \$59.2 million in payments to individual recipients for social welfare and an increase of \$58 million in payments to doctors, hospitals, and similar institutions who provide medical treatment to social welfare recipients.
- Debt service principal expenditures decreased by \$56.7 million due to debt refinancing.

The public education fund category provides general and special education services to the children of the State and other related functions such as library services and student loans. Total fund balance increased by \$20.7 million. Expenditures of the public education funds totaled \$3.6 billion in fiscal year 2004, an increase of \$44.9 million from fiscal year 2003. The major factor that contributed to this was an increase of \$60.9 million in the education expenditures for an increase in aid to educational institutions and school districts for expenditures by the institution or the district. There was also an increase of \$176.3 million to other financing sources and uses due to more General Revenue funding and an increase in funds from Lottery.



The conservation and environmental protection fund category provides for the preservation of the State's wildlife and environment. The fund balance increased by \$81.9 million. Revenues of the conservation and environmental protection funds totaled \$342.4 million for fiscal year 2004, an increase of \$1.7 million from fiscal year 2003. The factors contributing to the increase included the following:

- Taxes increased \$4.2 million primarily from an increase of \$3.6 million in conservation sales and use tax.
- Contributions and intergovernmental revenues decreased \$5.6 million due mainly to a decrease of \$6.3 million in federal receipts for grants or programs financed by the U.S. Environmental Protection Agency.
- Penalties and Unclaimed Properties increased \$1 million due to an increase in money received by the state to settle claims for goods, services or damages against the state.

Expenditures of the conservation and environmental protection funds totaled \$267.9 million for fiscal year 2004, an increase of \$19.5 million. The main factor that contributed to this was an increase of \$101.9 million to Intergovernmental Expenditures due to an increase in both aid to local governments and loans disbursed to other entities.

The transportation and law enforcement fund category provides transportation services, road construction and maintenance, and the enforcement of vehicle laws and traffic safety. The fund balance increased by \$15.6 million. Revenues increased \$23.6 million during fiscal year 2004. The major factor contributing to this was an increase of \$39.3 million in tax revenues due primarily to an increase of \$22.4 million in receipts of tax on gasoline for use in motor vehicles.

The State Road Fund accounts for revenues from highway users' fees, federal reimbursements for highway projects, and bond proceeds to be used for costs of constructing and maintaining an adequate state highway system. The fund balance increased by \$20.9 million in fiscal year 2004. Revenues of the State Road Fund decreased during fiscal year 2004 by \$119.4 million. The major factor contributing to this was a decrease of \$82.1 million in Contributions and Intergovernmental revenues due mainly to a decrease of \$60.8 million in federal receipts for grants or programs financed by the U.S. Department of Transportation. Other Financing Sources/Uses increased by \$243.4 million during Fiscal Year 2004. The main factor for this was an increase in proceeds from Other Bonds of \$254 million due to an issuance of State Road Bonds.

#### **Proprietary Funds:**

The State has three major proprietary funds: State Lottery, Unemployment Compensation, and the Petroleum Storage Tank Insurance Fund. The State Lottery was established in 1986 to account for the sale of lottery tickets and lottery operations. Since 1992, public education has been the sole beneficiary of lottery proceeds. Unemployment Compensation accounts for contributions and payments collected from Missouri employers under the provision of the "Unemployment Compensation Law". This tax finances benefits for workers who become unemployed through no fault of their own. The Petroleum Storage Tank Insurance Fund accounts for moneys collected from transport load fees and participating owners of petroleum storage tanks. The fund pays cleanup expenses from petroleum leaks or spills from underground storage tanks and certain above ground storage tanks as well as third party property damage or bodily injury resulting from such discharges. This fund is one of the largest insurers of tanks in the country.

The State Lottery Fund's net assets decreased by \$7.3 million. Although operating income increased because of more robust sales, transfers of public education also increased and the value of investments held for grand prize winners decreased substantially.

The Unemployment Compensation Fund's net assets decreased by \$180.1 million due to employer contributions and intergovernmental revenues insufficient to pay claims. During the year, loans from the Federal government were obtained as allowed by Title XII of the Social Security Act. The outstanding Federal liability was \$288.6 million at June 30, 2004.

The Petroleum Storage Tank Insurance Fund's net assets increased by \$13.6 million due to significantly reduced environmental cleanup expenses.

## GENERAL FUND BUDGETARY HIGHLIGHTS

The original budget is the first complete appropriated budget that is truly agreed to and finally passed, and signed by the Governor. The final budget includes emergency and supplemental appropriations, transfers, and increases to estimated appropriations.

Budgeted appropriations for fiscal year 2004 from the general fund were \$15.2 billion original budget and \$15.5 billion revised budget. Actual spending was \$14.7 billion. Reasons for the budget variances include:

- Revenue refunds were less than expected partially due to lower tax credit utilization.
- Federal grants received were lower than appropriation authority.
- The late receipt of federal moneys and late contract completion moved some expenditures from fiscal year 2004 to fiscal year 2005.
- Multiple year grants are appropriated in one year but the expenditures may occur over several years.
- Appropriation authority exceeded cash available for expenditures.
- Federal moneys related to Medicaid were lost because the Department of Social Services did not have available the money for the required state match.

Budgeted revenues/transfers in for fiscal year 2004 for the general fund was \$14.7 billion original budget and \$14.8 billion revised budget. Actual revenue/transfers in was \$14.8 billion. Reasons for the budget variances include:

- Revenue growth in fiscal year 2004 outpaced economic growth forecasts for the State. Many economic forecasting experts predicted strong growth in production, but slow growth in jobs. Since Missouri's revenues are highly dependent on withholding and sales taxes, continued conservatism in the forecast was justified.
- Tax changes at the Federal level, particularly the Jobs and Growth Tax Relief Reconciliation Act of 2003, created uncertainty and posed substantial downside risk. While some provisions of the Act benefited Missouri's revenues, the Act also raised the standard deduction for many filers and enhanced depreciation allowances.

Refer to the *Notes to RSI*, Budgetary Reporting, on page 95 for more information on budgetary variances.

## CAPITAL ASSET AND DEBT ADMINISTRATION

### Capital Assets:

The State's investment in capital assets for its governmental and business-type activities as of June 30, 2004, was \$27.4 billion (net of accumulated depreciation). This investment in capital assets includes construction in progress, infrastructure in progress, land, land improvements, buildings and improvements, equipment, and infrastructure. The total increase in the State's investment in capital assets for the current fiscal year was 0.9%.

**Capital Assets of the State include (In Thousands):**

	Governmental Activities	Business-Type Activities	Total
Construction in Progress	\$ 582,409	\$ 4,465	\$ 586,874
Infrastructure in Progress	3,011,466	---	3,011,466
Land	2,390,597	16,134	2,406,731
Land Improvements	90,489	7,068	97,557
Buildings and Improvements	2,014,569	26,757	2,041,326
Equipment	1,120,022	45,880	1,165,902
Infrastructure	37,312,836	---	37,312,836
<b>Total</b>	<b>\$ 46,522,388</b>	<b>\$ 100,304</b>	<b>\$ 46,622,692</b>

Additional information on capital assets can be found in *Note 5* of this report.

**Long-term debt:**

At the end of fiscal year 2004, the State had total general obligation and other bonded debt outstanding of \$2.5 billion. Of this amount, \$855.1 million comprises debt backed by the full faith and credit of the government.

During fiscal year 2004, \$150,305,000 of general obligation refunding bonds were issued to refund \$155,920,000 of general obligation bonds and to take advantage of lower interest rates. Other revenue refunding bonds of \$116,030,000 were issued to refund \$116,015,000 of other revenue bonds and to take advantage of lower interest rates. Other bonds were issued in the amount of \$254,000,000. Principal amounts retired in fiscal year 2004 were \$40,015,000 for general obligation bonds and \$36,460,000 for other revenue bonds.

The State of Missouri is proud to be one of only seven states to maintain a Triple-A credit rating from all three major credit rating agencies (Moody's Investor Services, Inc., Standard and Poor's, and Fitch Ratings, Inc.) on the State's General Obligation Bonds.

**Outstanding bonds payable of the State include (In Thousands):**

	Governmental Activities	Component Units	Total
General Obligation Bonds	\$ 855,115	\$ ---	\$ 855,115
Other Bonds	1,628,510	975,769	2,604,279
<b>Total</b>	<b>\$ 2,483,625</b>	<b>\$ 975,769</b>	<b>\$ 3,459,394</b>

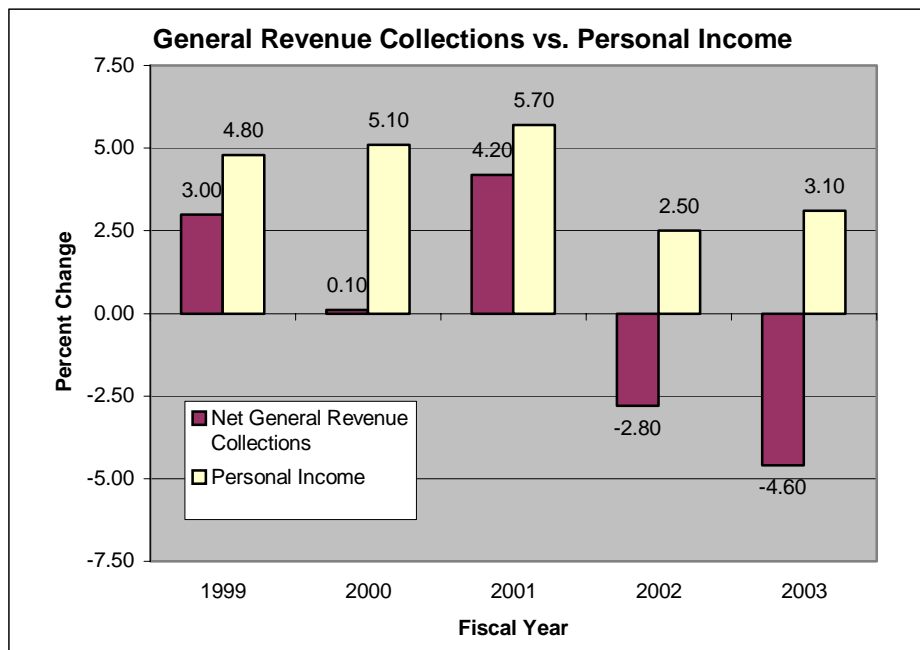
Additional information on long-term debt can be found in *Notes 11, 12, and 13* of this report.

**ECONOMIC OUTLOOK AND NEXT YEAR'S BUDGET**

The economic future of Missouri is increasingly positive as evidenced by improving economic indicators and statistics. Since July of 2003, the State's jobs growth was ranked second in the nation with the addition of more than 80,000 jobs, an increase of more than 3%. In addition to improving employment numbers, Missouri's economy is expanding as evidenced by the purchasing manager's index that considers variables such as new orders, inventory levels, and production. Further, Missouri's cost of living remains well below the nation average, currently ranked 37<sup>th</sup> out of 48 participating states.

While Missouri's economic outlook is positive, the State faces significant funding challenges including Medicaid, elementary and secondary education, higher education, and the correctional institutions. The State's fiscal year 2004 net revenue collections, although growing, are still below the pre-recession collections of fiscal year 2001. Simultaneously, the expenditure demands of priority programs continue to outpace general revenue collections.

The primary source of Missouri's net revenue collections is personal income tax, which accounts for approximately 60% of total tax collections. In recent years however, changes in personal income have not been mimicked by similar changes in income tax collections as shown in the following chart:



One explanation for the difference is that Missouri's income tax calculation is directly connected to the federal tax calculations. Any tax cut passed by the federal government, such as the Jobs and Growth Relief Reconciliation Act of 2003, results in additional tax cuts at the state level. A second explanation is that Missouri has numerous tax credits, which are redeemed at the taxpayer's discretion.

Costs of the Medicaid program have been growing substantially in recent years, consistent with the overall increase in health care in this country. The State continues to pursue cost containment measures including reducing the number of Missourians receiving Medicaid by more than 34,000 people and adopting a pharmacy program which has saved more than \$300 million dollars. For fiscal year 2005, the Medicaid program is anticipated to cost an additional 30% in general revenue spending.

Challenges also exist regarding funding for elementary and secondary education. Education continues to be a high priority therefore; the elementary and secondary education budget has not been cut to the extent that other state departments have in recent years. In Missouri, education is the biggest single expenditure with increases of approximately 10% per year. On January 6, 2004, Missouri schools filed a lawsuit against the State over both the equity of funding between schools and the overall adequacy of school funding. Although this lawsuit is still pending, an additional \$600 million is needed to fully fund the current school funding formula in fiscal year 2005 and an estimated \$800 million is needed in fiscal year 2006.

The State's colleges and universities have experienced substantial funding cuts. As a result, tuition increased at public colleges and universities an average of 14.8% while tuition increased at community colleges an average of 9.3%.

Another significant challenge facing Missourians is the continued operation and maintenance of the State's correctional facilities. Due to strict enforcement of sentencing laws, Missouri's prison population has been expanding in recent years creating increased pressure to build additional, expensive correctional facilities. During fiscal year 2004, increased research efforts and initiatives focused on improving rehabilitation and reducing re-entry of offenders. Additionally, legislative changes passed in Senate Bill 5 reduce the sentencing requirements for certain non-violent crimes while strengthening penalties related to violent crimes. Senate Bill 5 also allows the Department of Corrections more flexibility relating to certain treatment programs by reducing the minimum duration and adding incentives for successful completion.

Although Missouri faces significant challenges in the future, the State is working diligently to stimulate the economy, increase efficiency in government, and reduce costs when possible. In the past year, several legislative initiatives have passed to attain these goals including HB289 Missouri Downtown and Rural Economic Stimulus Act which assists communities in funding infrastructure projects, SB299 Performance Based Budgeting and Sunset Act which requires departmental budgets be based on performance, and the implementation of the SmartBuy program which helps the state consolidate purchasing power and reduce costs. These measures in addition to continued departmental actions to reduce costs and create efficiencies will result in Missourians continuing to be well served by their state government.

Events taking place after the State's fiscal year end include:

- Governor Bob Holden announced plans to open a state marketing office in Shanghai, China to assist Missouri companies compete in one of the world's fastest growing markets. Currently, China is Missouri's 5<sup>th</sup> largest trading partner. The Shanghai office will join Missouri's established international offices in Tokyo, Japan and Seoul, South Korea.
- Missouri's first "green" state office building, the Lewis and Clark State Office Building, was dedicated on October 24, 2004. The Missouri Department of Natural Resources staff will eventually occupy the new building which is expected to use 53% less energy than other comparably sized buildings. A few of the innovative building features include: water collection and recycling system that collects runoff from the roof and flush toilets, building design that utilizes natural sunlight, emphasis on recycled construction materials, and solar energy collectors on the roof.
- Missouri is the third state in the nation, along with Illinois and Wisconsin, to participate in the I-SaveRx program. The new program will allow Missouri citizens to purchase lower cost prescription drugs from 45 inspected and approved pharmacies in Canada, the United Kingdom, and Ireland.

## **REQUESTS FOR INFORMATION**

This financial report is designed to provide a general overview of the State's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the Office of Administration, Division of Accounting, P.O. Box 809, Jefferson City, MO 65102.